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THE REGULATION OF INSURANCE— DISCUSSION.

FRANK E. HORACK: Without entering into the constitutional or legal difficulties to be encountered and overcome before the organization and government control of insurance companies by the National Government can become a reality, I want to emphasize what in my opinion would be the chief advantages of such organization and control.

The fact that the insurance companies themselves are working toward this end is not necessarily against the proposition. Government control will undoubtedly benefit the insurance companies by giving them a uniform and simplified organization. This must mean a considerable economy in management over the present system. Moreover, I believe that if means are found to bring the insurance business within the power of the National Government, it will hasten the movement for the organization and control, or the control at least, of industrial and business corporations engaged in interstate business.

The insurance business is only one of the great enterprises conducted in corporate form in this country which must sooner or later come under the surveillance of the National Government. President Roosevelt urged national legislation for corporations engaged in interstate commerce in his first message to Congress and this year at the second session of the 59th Congress he again calls attention to the need of securing Government control of those great corporations the operations of which are confined to no one State. The impossibility of securing uni-

form legislation by State action is apparent to anyone who has given the subject the slightest thought.

In my opinion all of the arguments urged in favor of organization and government control of insurance companies may well be applied to all the great corporations engaged in interstate commerce. To sum up briefly, the advantages of Government organization and control are:

1. It will give such corporations a uniform and simplified organization.

2. It will make possible a uniform line of court decisions respecting the powers and duties of such corporations.

3. It will be one of the most efficient means of checking the evil of overcapitalization.

4. It will give better protection to policyholders and to stockholders, particularly in giving them information as to who their associates are.

5. It will give American companies transacting business abroad a better standing, as well as better protection.

6. It will check excessive profits and reduce the cost of insurance.

7. It will put a stop to the disgraceful traffic in corporate charters for the sake of the fees which the corporations willingly pay for immunities.

8. It will raise the standard of corporation legislation in this country on a par with that of England and Germany.

W. G. LANGWORTHY TAYLOR: Life insurance is not at all a gambling business, for its purpose is beneficial and its legitimate receipts and expenditures are less subject to fluctuation than those of perhaps any other business. But the endowment feature does not come in along with regular insurance for this praise. It is a gambling

on one's own survival and on the inheritance of the property of those who die before.

The social danger in life insurance, as recently conducted, lies in the collection of an excessive quantity of assets which are not subject to withdrawal for very long periods and are hence an enormous temptation to unfaithful stewardship. It is the endowment feature which has enabled the heaping up of these exaggerated funds.

The soundness of our financial system reposes entirely upon the great banking principle of payment on demand. It is this principle which regulates the flow of capital whither it is wanted, and capital not subject to its operation is an open invitation to promotion, with all its evils. All credit should bear a bank guaranty. In that case someone always has a string attached to it that he can pull at a moment's notice, *i. e.*, the guaranty can be called each moment.

At the best, life insurance involves the holding of considerable funds. The state is not adapted to this rôle; but may well encourage publicity, and there is no economic reason why the general government should not coöperate with the several states to this end. To be sure, insurance is not "commerce," because it is an operation of financial guaranty; but the lawyers are now arguing that it *is* "commerce"; and, if they want it so,—why, let them have it so!

FREDERICK A. CLEVELAND: Advocating publicity, Mr. Johnson, in his excellent paper on "The Principles which Should govern the Regulation of Life Insurance Companies," contrasts the almost complete absence of regulatory acts in Great Britain with the voluminous State insurance legislation in the United States, and concludes that the one provision—"publicity"—in Great Britain

has given a complete solution of the problem of regulation, while America with all her statutes—inquisitorial, restraining, and mandatory—has been periodically wrapped in scandal, and both policyholder and insurance company have suffered greatly from an inefficient form of control.

The conclusion reached by Mr. Johnson seems to be well supported by experience, not only by the experience of insurance companies, but also by English practice with respect to every form of corporate activity and executory trusteeship. From his reasoning, however, he has omitted an important feature of the English statute law, viz.: the provisions of the "Companies Acts", requiring the independent audit of all corporations registered under the act of 1862 and the specific acts requiring the audits of savings societies, friendly societies, railway companies, water, gas and electric lighting companies, etc. While the act of 1870, regulating life insurance, did not make obligatory the appointment of independent auditors by stockholders (or in mutual companies, by policyholders), and the Companies Act of 1890 includes only such insurance companies as were registered under the law of 1862, the defect in the law is effectively cured by an enlightened public opinion requiring financial statements to be certified to as a basis of credit and public faith.

The provisions and practice above referred to are the result of losses and scandals which occurred in the early part of the eighteenth century. Between 1840 and 1870 Parliament had enacted numerous measures for the protection of stockholders and other investors, an essential principle of which is as above indicated. As the representatives of stockholders and beneficiaries, these auditors were given access to all books, records, and files

kept by the officers and trustees of the company and are held civilly and criminally responsible for the truth of financial statements made. Such companies as do not specifically come within the statute find it to their advantage to have the certificates of auditors on their statements.

The contrast between the English method of control and the American is pointed. England throws the primary burden of control on the stockholder or beneficiary, and by law provides the means necessary to its enforcement. In the United States we have followed the Continental practice. We have assumed that the Government is the guardian of the stockholder.

Let us look more closely to the practices of companies which have been made the subject of criticism and consider whether or not these practices come fairly within the purview of public regulation, or if so, whether the public officer is the one to apply the remedy. The causes of complaint may be summarized as follows: (1) There was no adequate method whereby the administrative officers of the company might know whether all of the income accruing to the company had been realized, and consequently no adequate administrative control over the collecting agents; (2) there were expenditures amounting to millions of dollars per year over which the company itself provided for no adequate audit, or effective accounting control; (3) in some instances, even such audit as was provided for by the company was from three to four years behind—*i. e.*, the insurance companies were doing just what the United States Government is doing to-day, *viz.*: paying claims against them, then auditing these claims later, seeking to hold the disbursing officer responsible; (4) as a result there

has accumulated on the books as "unadmitted items" hundreds of thousands of dollars, which, though stated as assets under the head of "due from agents," were lost to the company and thereby were diverted from possible use as dividends; (5) supplies amounting to hundreds of thousands of dollars per annum were purchased at exorbitant prices, and in some instances at least with collusive intent; (6) salaries were arbitrarily raised far above the value of services received; (7) there were loans to friendly interests at rates below the market, in the form of call loans and deposits; (8) there was subversion of funds by agents for private or improper purposes; (9) there was lack of co-ordination between different departments of the service and the consequent loss in administrative efficiency; (10) there was lack of intelligence on the part of those in positions of official responsibility as well as on the part of the board.

The present trend of legislation is to add more restrictive and mandatory legislation to that which has already proved ineffective. The best regulation possible to business is to place in the hands of parties in interest data which will enable them intelligently to judge as to the manner in which the affairs are being managed. This can best be done by means of a compulsory audit by a representative of the proprietors and beneficiaries—by one who for purposes of examination and report is made superior to the officer and trustee. The necessity for making an audit compulsory is to insure that the report shall go to the real parties in interest instead of being buried in the archives of state or concealed from view by the officers whose acts are being reported. The necessity for making the auditor civilly and criminally responsible is to make responsibility for an examination so great that

one not trained to this character of advice cannot afford to take the risk of certifying to statements of financial condition and current operative results. By requiring an independent audit of statements of affairs under such penalties and liabilities, and subject to review by officers of state, both public and private control over insurance companies may be made most effective.

FREDERICK L. HOFFMAN: The address of Prof. Robinson before this Association marks an important step in the advance of insurance science as a branch of economics. The observations, on the whole, are sound and in conformity to the facts, and the address illustrates forcibly the value of independent and impartial research work in practical economics. The scientific study of insurance has been almost completely neglected by economists, with the exception of the valuable monograph of Mr. Allan H. Willett, and the occasional discussion of its social aspects and importance by Prof. Ely, of Wisconsin. A very promising field lies open to anyone, but no more serious error could be made than to assume that all the knowledge and wisdom respecting the business is to be found in the Report of the New York State Legislative Committee, or in the Report of the Special Committee of the Legislature of Wisconsin. Insurance has a large literature and most interesting history, but few trained minds in economics have given the matter serious concern, and the subject awaits the coming of the master mind which shall successfully differentiate the sound theory from the unsound, and the valuable material from the worthless. In no direction, perhaps, is the value of special research work on the part of trained economists better illustrated than in connection with the constitutional aspects of the problem of Federal supervision of

insurance, or the specific question whether, under our Constitution, insurance is commerce or an element of commerce within the meaning of the Commerce Clause. Now, while there has been much discussion upon this point, there has been practically no research work to establish with accuracy the point of view of the early American statesmen from a study of the works of Hamilton and Wilson, the early American State Papers, the debates of Congress, etc., not to speak of the much-neglected field of the actual practice of ancient and modern commerce and navigation.

Much valuable material will be found in the early dictionaries of commerce and dissertations upon the Law Merchant; maritime law and custom, and even international law, contain much that will prove useful and suggestive. In other words, there is urgent need of a comprehensive inquiry into our political and commercial history, to ascertain whether or not in the early debates and discussions, insurance has been considered an element of commerce in the same sense as bills of lading and bills of exchange. It is to be hoped that some earnest student of economics will take up this question and produce a work useful for practical purposes and an aid in the successful solution of the pending problems, of the relation of insurance to the State.

Not much good, however, is likely to result until the whole subject of insurance is included within the scope of university education and until the science of insurance is taught in the same manner as other applied sciences are now being taught in our great institutions of learning. An excellent beginning in this direction has been made in Germany by the establishment of an insurance seminary at Göttingen, Germany, under Prof. Lexis, and of an insurance course in the Commercial High School at

Cologne under Prof. Moldenhauer. In so practical a country as America, it is difficult to understand why insurance has not long since attained to the dignity of an applied science and been taught as such in our universities. By such teaching I mean more than the actuarial branch of the business of life insurance, for I would make the instruction include every department of the business, or, in other words, insurance science in the true and complete sense of that term. The division is natural into different sections—such as, first, the economics and theory of risk and insurance; second, the history and literature; third, the law of insurance, both private and administrative, including State supervision and control; fourth, the mathematics of insurance, or the practical application of the doctrine of probability; fifth, the finance of insurance, including the doctrine of interest; sixth, the administration of insurance companies, including the science of accounting; seventh, insurance medicine, including hygiene and the diseases of occupation; eighth, the business of insurance in practical life, or its social aspect, including statistics, comparative experience, social utility, etc.; ninth, insurance technology, including insurance engineering, prevention of fire waste, etc.

If some such comprehensive plan were introduced into one or more of our leading universities, in place of the present more or less inadequate method of instruction, and if the co-operation of the companies were enlisted, to secure material and data, literature and forms, etc., the step would mark the beginning of a new era and the result would be to substitute facts and truth for error and guesswork, and the benefit to society and the State would be incalculable.

LEWIS A. ANDERSON: The last speaker (Mr. Johnson) has spoken at considerable length about publicity, limiting himself, however, to general principles. I would like to ask him one or two specific questions.

First, would he be willing to publish the dividend factors used by his company?

Second, would he be willing to put into the policy a table showing how much was collected to defray expenses of management, how much was collected for *cost of insurance*, and how much was set aside each year as a reserve?

I am fully aware that my questions will meet with opposition. We had those questions discussed at the meeting of the general agents in Milwaukee and I am quite familiar with the objections that have been made against the insertion of such a table in the policy.

I would like to say just another word since the Wisconsin Investigation Committee has been referred to. There seems to be an impression current in the East that the recommendations of the Wisconsin Committee are unreasonable. I will venture to say that when the report comes from the printer some parts of it at least, will not appear as bad as the rumors that have been circulated about it. Some parts may be worse. I want to correct the statement made by my friend, Mr. Hoffman, to the effect that the Wisconsin Committee rejected everything recommended by the Armstrong Committee. The fact is that the Wisconsin Committee adopted many of the recommendations of the Armstrong Committee, and of the Massachusetts Committee as well.

Perhaps it might not be out of place in this connection to call your attention to the fact that there are three kinds of insurance investigations. First, there is the actuarial or departmental examination made by the various state de-

partments, which concerns itself almost wholly with the question of the solvency of the companies. That is to say, they value the policies and appraise the assets. If the assets are sufficient to cover all the reserve liabilities and leave a working surplus, the company is given a clean bill of health and that is the end of it.

Second, there is the lawyers' investigation which consists principally of calling witnesses to the stand to determine whether or not there have been any questionable transactions.

Third, there is the economic and social investigation which may or may not include both of the other two. Its object is to determine the economic and social efficiency of insurance. That is, to determine what is actually received as benefits for the premiums paid as well as to determine whether or not the burdens are equitably distributed among the individual members.

The Wisconsin Committee has gone deeper into the question of insurance from the economic and social standpoint than any other committee ever did. I cannot at this time discuss in detail the data gathered by our committee, but will state very briefly some of the most striking results.

First, there is an appalling amount of social waste resulting from the lapsing of policies before surrender values take effect, as well as from the heavy surrender charges imposed by many companies when policy-holders surrender their policies.

Second, the lapses appear to be by far the greatest among the small policies and this goes to show that the greater part of this social waste is borne by those who are least able to bear it.

Third, panics and hard times have considerable effect on the lapses and surrenders, especially if the policies

have been recently issued when the financial disturbance comes.

Fourth, quite contrary to our expectations and contrary to the contentions of some insurance men, the annual dividend policies were shown to be much more persistent than the deferred policies, in some cases the difference being over one-third.

Fifth, it appears that the present method of loading the premium to defray expenses is unscientific and grossly unequal as between the individual policy-holders having different kinds of policies, and for this reason the committee recommended that the companies be required to show, when the application is written, how much is collected each year for the purposes of expense, cost of insurance, and reserve. The plan is entirely feasible; it is perfectly just, for it is publicity of the most effective kind.

I also wish to say that I heartily agree with the views expressed in Prof. Robinson's paper in its advocacy of federal supervision, because uniformity in the legal requirements is highly desirable if not absolutely essential to an effective control of the business. We can never have uniformity as long as forty or fifty states legislate independently of each other to regulate the same companies.

WILLIAM C. JOHNSON: I believe it to be unquestionably and essentially true that the interests of the public—the policyholders and their beneficiaries—will be best protected, not through paternalistic interference by the State with the details of management which properly fall within the province of the directors, but by the enforcement of an efficient publicity and a strict accountability. Supervision by the State has been tried and found wanting. Although the fifty States and Territories have all attempted to

supervise the business of insurance within their borders, and possess the right to examine at will into the affairs of any company doing business with their citizens, yet not a single State department has exercised any real supervision or taken any actual steps to see that the interests of the public were protected. The grave evils in the conduct of certain companies, which were disclosed last year, did not become public through their discovery by any of the many departments of State supervision. State officials were apparently blind to conditions the very existence of which was indicated to any intelligent observer of the annual reports of some of the companies. It was not until the evils of extravagance, of graft, and of corruption became so great that they gave rise to spontaneous combustion, that supervising officials commenced to take notice of the facts. The interests of the policyholders can never be adequately safeguarded by a State supervision which experience has proved to be both deaf, and blind, and dumb, which is sometimes dishonest, usually inefficient, and which, even if conscientious, is lacking in intelligent appreciation of the situation and of the remedies which will best conserve the interests of the policyholders. With publicity and accountability required of all the companies, the public will have from year to year the means of knowing which companies are giving the best returns to their policyholders in the matter of the cost of the insurance granted; and by putting the companies in a position where through publicity and comparison of results the meritorious will attract patronage and those of lesser merit repel it, an automatic method will be provided for checking evil and for insuring an honest, intelligent and conservative management of all life insurance companies.

The past half century in the insurance business in this

country has been an era of freedom *without accountability and publicity*. It naturally led to evils which are now familiar to you all. The reaction has been so great that the trend of legislation is now toward publicity and accountability, *without freedom, i. e.*, with statutory interference with details of management. The pendulum is swinging too far, and what is really needed, what will best protect the public and at the same time lead to the greatest extension of the business along legitimate lines, is an era in which company managers will possess the original freedom, with the publicity and accountability which have not existed in the past, but upon which the public may now properly insist. The tendency is to condemn freedom and demand that the State should interfere, but freedom led in some companies to results to be condemned only because with it *accountability and publicity were never enforced*; and if the State will be wise enough to enforce the requirements just named and leave to company managers the same freedom, experience will prove the soundness of the practice of permitting the directors and officers to exercise their initiative in conducting the business for the benefit of the policyholders, and extending its benefits as experience may justify. Unorthodox as the statement may seem in this period when we hear so much clamor for legislation from those who know so little about the business, trained minds, the intelligent insurance men who for so many years have been closely devoted to the study and the conduct of the business, are keenly interested in and better able to advance those methods which will best conserve the interests of the policyholders, than any other class in the community. The end to be sought will be reached sooner and more certainly through freedom hedged by publicity, than by statutory rules, applicable alike to differing conditions

and framed by men whose sole qualifications for such work are usually their lack of familiarity with the actual conduct of the business and their sincere interest in the welfare of the policyholder. An expert has been defined as one who sees all sides of a subject at one and the same time. The non-expert mind sees but a single side, and sometimes sees that but dimly. The situation needs expert treatment, and if company managers rather than the State are left free to conduct the business, government requiring only that it shall be done in the light of day with an annual accounting to the policyholders, the public interests will be best served.